PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Meeting of the Federal Open Market Committee

September 22, 1987

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, September 22, 1987, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Boykin
Mr. Heller
Mr. Johnson
Mr. Keehn
Mr. Kelley
Ms. Seger
Mr. Stern

Messrs. Black, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Guffey and Melzer, Presidents of the Federal Reserve Banks of Kansas City and St. Louis, respectively

Mr. Kohn, Secretary and Staff Adviser
Mr. Bernard, Assistant Secretary
Mrs. Loney, Deputy Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Truman, Economist (International)

Messrs. Lang, Lindsey, Prell, Rolnick, Rosenblum, Scheld, Siegman, and Simpson, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International Finance, Board of Governors
Mr. Slifman, Deputy Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Office of Board Members, Board of Governors

Messrs. Eisenmenger and Hendricks, First Vice Presidents, Federal Reserve Banks of Boston and Cleveland, respectively

Messrs. Balbach, Broaddus, T. Davis, and Ms. Tshinkel, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Richmond, Kansas City, and and Atlanta, respectively

Mr. R. Davis, Senior Economic Adviser, Federal Reserve Bank of New York

Messrs. Judd, McNees, and Sniderman, Vice Presidents, Federal Reserve Banks of San Francisco, Boston, and Cleveland, respectively

Ms. Ann-Marie Meulendyke, Manager, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting
of September 22, 1987

CHAIRMAN GREENSPAN. Good morning, all.

SEVERAL (in unison). Good morning.

CHAIRMAN GREENSPAN. Would somebody be good enough to move the minutes?

SPEAKER(?). I move.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Objections? Approved. Mr. Cross.

MR. CROSS. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Comments? Any motions?

MS. SEGER. May I ask just one question?

CHAIRMAN GREENSPAN. Sure.

MS. SEGER. How much actual trading is going on in the foreign exchange market for what I would call corporate business use? In other words, not just trading for the sake of trading but for--

MR. CROSS. Right now we have the feeling that corporations are not doing very much. It varies a great deal, of course, but typically the total turnover in the market is many, many multiples of what the final users get. It may be 10 times as much. But right at the moment we don't get a sense of a lot of corporate activity taking place. It may be that they are holding off, for the kind of reasons that I mentioned. It may be that they are waiting to see if anything emerges out of these dealings around the time of the IMF meeting. Or, from what I hear this morning, there is some expectation being talked about that the G-7 might do one thing or another that would give some greater strength to the dollar. They may be holding off for these kinds of reasons.

MS. SEGER. I remember before when there was all this turbulence, a lot of corporate traders did just sort of sit it out and hold off on decisions.

MR. CROSS. At times they do this. They can be very big players in this game, too, and they can do a lot of churning themselves.

VICE CHAIRMAN CORRIGAN. In general, based on a number of these periodic surveys that have been done, the thinking is that the percentage of transactions that will in some sense be related to the underlying exchange of goods is very, very small.

MS. SEGER. That isn't what I would suggest at all. I am just trying to sense what the attitudes in corporate America might be. No, I don't think--

MR. CROSS. This always seems to be a pretty important time for an assessment. We have the sense that they come back after Labor Day and reassess their position; and they may be doing that right now. Frequently, in recent years, we have seen trends begin shortly after the summer holidays and after Labor Day. As I said, it may be that they are holding off to see if anything emerges from these meetings next week.

MR. GUFFEY. There is some comment in the press saying that the G-10 or the G-7 had adjusted their target levels from 140 or 160 to 131.50. Is that rumor, or is that--?

MR. CROSS. That's total conjecture. There was a rumor last week of exactly that--that the target range had moved down. And then there was a rumor two days later that it had moved up. The dollar went down a little when the first rumor occurred and moved back up a little when the second rumor occurred. But these are all purely imaginative.

CHAIRMAN GREENSPAN. I have a motion; do I have a second?

MS. SEGER. Second.

CHAIRMAN GREENSPAN. Without objection, we'll assume the transactions are now ratified. Mr. Sternlight.

MR. STERNLIGHT. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Any questions for Mr. Sternlight?

MR. MELZER. Peter, you reported on the first 11 days; there is apt to be a pretty large borrowing spike Wednesday. How would you expect that to be interpreted in this environment? This is a period that has had some technical problems with the tax date, so I guess you are not going to be able to conclude much from that either.

MR. STERNLIGHT. I wouldn't be surprised if there were some kind of a spike. I don't know what the average would work out to be. We'll be seeking to put in reserves, so that if our estimates are close and our estimates of the demand for excess are close, the average will come out around the $600 million level. There is always an element of uncertainty as to just how far a spike takes you. But I think there is a lot of realization in the market that this is a very difficult period for reserve management.

MR. JOHNSON. Peter, you mentioned the market being nervous. I agree that there is still some of that, but I think we did achieve--though I realize it hasn't been fantastic--some flattening in the yield curve out of the discount rate move. Even though the long end went up to around 9.80 percent at one point, it has settled down around 9.60 percent; and we have seen a larger move on the short end of the market than we have on the long end, even though it has fluctuated.

MR. STERNLIGHT. I think if you measure it just from the time the discount rate moved, there would be some flattening. The short rates came up more than long rates. I think if you looked at the whole intermeeting period, it is about similar at the short and long end of--

MR. JOHNSON. I wouldn't do that because [unintelligible] it could have been some fear of Fed tightening preceding it. But I think the tone seems to be more inflation fears or psychology, or the dollar, and everything else, more than just--. I don't know how you sort all this out. But still it does appear that there has been some flattening achieved.

MR. STERN. On the other side of that coin, and at the risk of some overstatement, I had the impression that the discount rate change was received with a combination of indifference and resignation more than anything else. Could you comment on that?

MR. STERNLIGHT. I am not sure what to say. I wouldn't say that there was a very widespread expectation; there was some expectation of the move, and there were even some people who were thinking in terms of a larger move. And, initially, there were some who expressed disappointment that it wasn't larger, although I would have to think that a small, vocal, minority was expressing that view. I suppose there is a sense in which [your observation] is true; people who recognized that the dollar had been under pressure and was likely to be continuing under pressure have come to expect that our rate structure and our policy formulation process will be under that kind of pressure. So there was that element of resignation to the process.

MR. FORRESTAL. Peter, is there an expectation in the market of further tightening by the Fed?

MR. STERNLIGHT. Not in any imminent sense, but I think there is an expectation that the dollar is going to remain under pressure, given that we have this awful trade balance picture; and that would be the kind of atmosphere under which there would have to be further policy response.

MS. SEGER. Peter, did I understand you correctly when the question was asked about the market response to what might happen to borrowings before this maintenance period is up? Did you say you thought we could come in around $600 million without stirring things up? Isn't the arithmetic to get $600 million in this period such that it would require tremendous borrowings today and tomorrow? And if those borrowings occur in the context of the knowledge of this meeting date, I think [market participants] might make something out of that rather than just saying, well, it is one way to get the average to work out right. I don't think they know what we are shooting for.

MR. STERNLIGHT. It would take some bulge in borrowing to get up to the $600 million [average]. I don't have yesterday's figure yet, but borrowing had been averaging $460 million through Sunday. So there would have to be some bulge, probably, on the final day. And as I said, if you ask the people who follow these things closely, most of them would probably think of us as using $500 million, although some would say a range of $500 to $600 million. If they saw a number like $600 million coming out, some of them might regard that as indicative of a little firmer aim than they had estimated earlier. On the other hand, they also were aware that it was very tough to manage reserves in this period. So, I don't know that they are going to jump immediately to any very strong conclusion if the borrowing comes out at $650 million, or something like that.

MS. SEGER. Yes, but if there is all this nervousness in general, and if you average, let's say, $625 or $650 million, with $2 billion of borrowing on Wednesday--which happens to be the day after we meet here--there must be weirdos, anyway, who will think maybe there is a connection. Maybe in New York they may figure all this out, but there are a few other market participants outside New York who might make something out of that whole sequence.

MR. STERNLIGHT. Just because of the juxtaposition vis-a-vis the Committee meeting date, possibly more [than a few]; but I think more of them would just tie it to knowing that Wednesday is the settlement date of the reserve period.

CHAIRMAN GREENSPAN. I think there will be critical questions regarding what happens, not so much on Wednesday, but because that type of spike is very difficult to interpret; they will look at borrowing very closely in the next maintenance period.

MR. KEEHN. Peter, you suggested that the increase in long-term rates is a combination of factors, with inflation being one. But, in the combination of factors, how persistent is the inflation concern and is it just one of those issues?

MR. STERNLIGHT. Well, the concern is very much tied to the dollar. And when concern about the dollar [is high], the market is more concerned with what would tend to happen with respect to inflation. The market has been reasonably well impressed with the actual price index numbers that have come along in the recent period. But they do worry that, in the course of redressing the trade deficit, we are going to be imposing more demands on our resources--that there may well have to be further adjustment in the value of the dollar and that that will do things to import prices, and so on.

MR. KEEHN. But it is more that side as opposed to domestic pressures?

MR. STERNLIGHT. Well, I think that even with the trade picture, it is partly domestic pressure because, as you are redressing that trade imbalance, you'll be putting more pressure on domestic resources.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Following up on Chairman Greenspan's comment, Peter, suppose that in the next maintenance period you do come in pretty close to $600 million and the market now expects $500 to $600 million. Would you expect much rate movement if you got closer to that figure?

MR. STERNLIGHT. I would expect a modest firming. My guess is that you would get funds rates averaging in the 7-1/4 to 7-3/8 percent area. I think we are averaging 7.15 or 7.20 percent so far this period.

MR. PARRY. Peter, has there been much discussion of the impact of higher interest rates on Treasury requirements? One hears a lot of discussion from the Administration recently about the deficit, at least in fiscal 1987, being somewhat lower than their estimates because of revenues going up. But I don't hear much discussion of the impact of higher interest rates on future requirements.

MR. STERNLIGHT. I have not really heard discussion of that particular factor. However, while people are well pleased with the deficit coming out this fiscal year at $160 billion, or somewhat under, there is deep concern that without the Congress getting something together on fiscal restraint, it will be heading up by $20 billion or more next year.

CHAIRMAN GREENSPAN. Any further comments or questions? If not, I will entertain a motion to ratify.

VICE CHAIRMAN CORRIGAN. So move it.

MR. JOHNSON. Second.

CHAIRMAN GREENSPAN. Objections? Approved. Mr. Prell.

MR. PRELL. Thank you, Mr. Chairman. I think I can be relatively brief this morning. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Thank you, Mr. Prell. Questions for Mr. Prell?

MR. FORRESTAL. The only thing that kind of jumped out at me in your forecast this time, and I guess this has been there before, is on the real export side. You are showing a marked deceleration of the [trade] deficit; real net exports, for example, going from [an annual rate of $131 billion in] the third quarter of 1987 to $63 billion in the fourth quarter of 1988. Most of the other forecasts that I have seen would not indicate nearly that much progress. Can you tell me what that dramatic improvement is based on? Is it basically on the export side or in the diminution of imports or a combination of both, or what?

MR. PRELL. Well, the greater strength is clearly on the export side. As we go out through the forecast period to the end of next year, we have very modest increases in imports; indeed, we would expect that real merchandise imports, not only [nominal] merchandise imports, will be going down slightly, largely in response to the past and prospective depreciation of the dollar. We are also anticipating, of course, that domestic spending--consumption, in particular--will be growing rather slowly, so we won't be sucking in great volumes of imports because of the continuation of the kind of demands we have seen previously.

MR. TRUMAN. I don't think that should govern [unintelligible]. If you look at outside forecasts that go into detail on real exports you will [not] find that much difference between [unintelligible] and exports over the forecast horizon from ours. Generally, they do show very substantial declines over the period. DRI, for example, has something very close, almost shockingly close, to what we have.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. Mike, you spoke about the sharp increases in business equipment spending. How does that break down between additional capacity and efficiency enhancing?

MR. PRELL. That's very difficult to get a handle on. The anecdotal evidence--or if you want to characterize it in more solid terms than that, the kinds of survey information that are gathered by McGraw Hill and others--suggests that vis-a-vis historical experience, a distinctly above-average percentage of this planned spending is designated as being for replacement, modernization, and so on. Clearly, in many industries there is plenty of capacity; in others there is less. And one can identify some areas of significant expansion of capacity, with additional plants being built. But, generally, as we are looking at it, the major thrust will be on continuing to reduce costs, to modernize product line, and so on.

CHAIRMAN GREENSPAN. It is most likely to show up first in increasing lead times on the delivery of materials. In other words, leaving aside the question of where the pressures are, that's the first sign that you are going to get something of that nature--that is, capacity expansion. There has got to be some evidence on the part of the company that it is having difficulty in maintaining deliveries on a relatively quick pace. Am I correct in assuming that there has not really been any major change, or that there has been a slight increase--

MR. PRELL. For materials, the lead times have been lengthening. I think, implicit in your comment, is the question of whether they have increased to levels that are not comfortable, and I suspect that the strategy in many firms has been to run with a little tighter capacity than they might have in the past. And they may not be uncomfortable with what they are seeing. In the capital goods area, average lead times don't seem to have lengthened much yet; and that is probably consonant with the evidence that the capacity utilization in equipment producing industries is not especially high--not what one sees in some nondurable material areas, for example.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I would like to ask two questions about your assumption with regard to fiscal policy. This time, as has been the case in the past, there is an assumption that there are spending cuts of around $25 billion. I think there is a substantial risk that that will not materialize. Some work we have done suggests that if policy is accommodative and you don't get that $25 billion deduction in spending, that it could add approximately a percentage point to growth in 1988 and a half percentage point to inflation. Would you think that to be roughly [the magnitude]?

MR. PRELL. I take it you are going to zero on the deficit reduction action with that.

MR. PARRY. You don't get the $25 billion reduction; you get zero.

MR. PRELL. I think that is probably a little higher than our normal econometric results would give us, but it is clearly the direction in which we would go. At this point, the $25 billion looks like a reasonable ballpark figure, given what is being discussed currently in a compromise--a Gramm-Rudman revision that would be something like $23 billion, with no loan sales or that sort of thing. But I suppose there are still some risks that it would be less than what we have and the result might well be somewhere in between that zero and the $25 billion that we have.

MR. PARRY. One further question: I notice the change in the assumption you have made with regard to the size of the deficit. I guess it would primarily be the higher interest rate assumption over the forecast horizon. Does that feed back into income? In other words, is the loop closed in the model so that you get higher growth of disposable income as a result of the higher interest payments on the deficit?

MR. PRELL. Well, the forecast isn't generated by a model, per se. As we go through and estimate the income flows, we definitely do take account of the interest rate path that we've assumed and projected. And we do have substantial growth in personal interest income over the projection period.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I would like to follow up on Bob Forrestal's question. Basically, the U.S. strategy for turning the trade deficit around is to shrink the value of the dollar and to get our trading partners to grow faster than we are growing. We have done fairly well on the dollar, but we haven't done so well on growth abroad. It's an appealing strategy, but it strikes me as being somewhat novel if you look at the history of these kinds of adjustments. What has happened most often is that the country that has the deficit ends up with a recession. In other words, you reduce domestic demand below what is happening abroad and you also get downward adjustments on the currency. And I would think that the longer it takes for us to make a turnaround in the trade deficit--as we get month after month of these disappointing trade figures--that it would put additional downward pressure on the dollar. And it might also begin to raise expectations that, well, as nice as it sounds to try this rather novel strategy, in the end, the U.S. is going to have to go through kind of a wringer, as most other countries do. My real question is: How much of a novel experiment are we really running in light of what is happening in other countries and what has happened over history? I am having a hard time thinking of a country that hasn't turned around this kind of a trade deficit without a fair amount of suppression of domestic demand. And the question is not aimed at [criticism]; I like the approach that we are on. But it does strike me as somewhat novel on the broader stage of history. I would just like to see if that is right or if we have had lots of company with this experiment.

MR. TRUMAN. Well, the truth of the matter is, President Boehne, that there are some examples where this has been successful. A lot of them come from the early 1980s and, of course, during that period where you had essentially [slow growth of] GNP without going through a recession--that is essentially the question you are asking--in a relatively short period of time. There are several examples in the early 1980s and, of course, those were [unintelligible]. The other side of the equation, which you mentioned, is faster growth in the rest of the world, which was then the United States. And there are some other examples. We did look at this record about 18 months ago and that is basically what it showed.

MR. BOEHNE. Are these sizable countries?

MR. TRUMAN. Germany and Japan [unintelligible]. We tend to forget that they had deficits in the late 1970s and at the beginning of the 1980s. They moved from small deficits to very large surpluses. One feature of the forecast is that, while we don't have a recession in a GNP sense built in, we do have relatively slow growth in domestic demand. In fact, we have a quite dramatic slowing of domestic demand built into this forecast. In some sense, as Peter was saying earlier in answer to your question, that's part of the process--the process that makes room for this external adjustment in an environment in which growth of production as a whole is kept relatively high but domestic demand growth is low.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Mr. Chairman, I have a couple of questions for Mike with respect to the sections that caught my eye in the forecast. You mentioned that a further decline in the dollar was assumed in your forecast. As I remember, the Greenbook only made reference to a decline much like that projected in the last Greenbook. Further, as I remember, that decline was 10 percent on an annual basis, and most of that had been completed in the first half of the year. Am I correct, or is there further decline assumed?

MR. PRELL. I guess I wasn't clear. The assumption is that the dollar will decline further over the forecast period. For our purposes, we put in a straight line path that averages about 10 percent, at an annual rate.

MR. GUFFEY. My second question has to do with your assumption about rising interest rates in the fourth quarter. To be very specific, do you have a level of interest rates in the fourth quarter that you assumed in this forecast?

MR. PRELL. It isn't necessary that there be a precise course. We put in a smooth trajectory that moves the federal funds rate, for example, into the 8 to 8-1/2 percent range by next spring.

MR. GUFFEY. In the first quarter?

MR. PRELL. We would be approaching it by the end of the first quarter. I don't want to be too precise about this. If there were flatness over the next few months and more increase later on, we wouldn't be able to distinguish the economic effects in the forecast for the period as a whole. But we do have a gradual rise here.

MR. GUFFEY. My last question has to do with your comment about inflation picking up--I guess that's in 1988, if I read the Greenbook numbers correctly, because your forecast has it actually declining in the last quarter of this year, as measured by the fixed-weight index or the deflator itself.

MR. PRELL. There's a difference in our forecast between the deflator and the fixed-weight GNP measure. In the fixed-weight index, we have 3-1/4 percent for the third quarter and 3-1/2 percent for the fourth, whereas there's a deceleration from 3-1/4 percent in the third quarter down to 2-1/2 percent in the deflator. The difference there is the peculiarities of weighting shifts that occur in the GNP deflator; and the decrease in oil imports, which have a relatively low weight in the deflator, actually tends to depress the GNP deflator relative to the fixed-weight measure. Basically, we have a fairly steady second-half inflation, as we see it; it's lower than in the first half, in large part because of lower food and energy price inflation.

MR. GUFFEY. So is it fair to say, Mike, that inflation in the second half, and particularly in the last quarter and maybe even into the first quarter of 1988, is reasonably stable in your forecast?

MR. PRELL. In some underlying sense, there is a fairly stable picture between the first and second half, but that's in this game of stripping away food and energy prices, which obviously are affected by special nonmacroeconomic influences in the short run. Of course, there are peculiar things that affect other sectors, as well. But, basically we have a fairly stabilized underlying trend, and some increase next year in the rate of price inflation.

MR. PARRY. But the underlying inflation must pick up quite a bit, because you have a marked acceleration in labor costs.

MR. PRELL. Some people would take that as an indicator of the underlying rate of inflation. And yes, we do, as compensation accelerates significantly next year. In that sense, the underlying trend is picking up.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, most of the comments have been directed at particular parts of the forecast. My feeling the last time was that the economy would be somewhat stronger than the Greenbook was projecting, and the staff, indeed, have moved their forecast in that general direction. So, we have very little quarrel with what they have done. We think the main driving force is going to be an improvement in net exports of goods and services; and plant and equipment expenditures, particularly in the equipment area, also provide a pretty good push. If we were to guess, we would say the risk might still be that the forecast is a little low. But really what bothers us, I guess, is the feeling that they might be right on this forecast. In saying that, I'm focusing on the inflation rate that they are projecting for next year--when it goes up to 4-1/2 percent. I think we ought to be able to do better than that for next year, and we ought to target something less than that. A 4-1/2 percent inflation rate could easily become 5 percent; and 5 percent is not really reasonable price stability. So, rather than thinking they may have overestimated, we're afraid that they might be about right and have come up with some results that are a little too strong on the price side.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. Yes, I just have a couple of questions that are tied to a few matters that we discussed yesterday at pre-FOMC briefings. These involve whether or not we have completely factored in the rise in interest rates that we have already seen, plus wholly factored in the increases that we think are yet to come. In particular, on housing starts, which as of last month were at a 1.6 million annual rate, we know that there are problems with high vacancy rates in the multifamily area, at least in some parts of the country. The incentives built into that kind of housing have been shifted greatly by the Tax Reform Act. As for single family starts, at least some people say they are sensitive to interest rate changes. I guess I have a hard time believing that for 1988 starts will not fall below 1-1/2 million. I hope they don't, but I am sort of skittish about this.

MR. PRELL. It's purely conjectural at this point. Various econometric models would suggest that, over the relevant horizon here, you are probably dealing with an interest rate elasticity of about 1. We have a rise in mortgage rates from around 10-1/2 percent to something in the high 11's, [an increase of] roughly 10 percent. We have roughly a 10 percent decline in housing starts, from 1.6 million to something around the 1.45 million area. In that sense, it's well in line with the historical patterns. The other thing that provides some comfort--

MS. SEGER. Is that true for both the single family and the multifamily?

MR. PRELL. Well, I'm looking at it in the aggregate; clearly, they are both to be affected by the change in interest rates. Looking at it from another angle, mortgage rates are back up to levels we saw in 1985, and we had considerably higher housing starts then--in the 1.7 million area. Now, we've probably gone through some catchup period in home ownership, but that number seems fairly reasonable to us, looking at the response we've seen just so far to the substantial increase in mortgage rates. It hasn't made the market fall apart entirely. We may not have it quite right, but this is a stab at what we think is a normal response.

MS. SEGER. What if it just means that the lags are longer? Maybe we haven't even seen the full impact of the spike we had back in April or May, which was quite dramatic.

MR. PRELL. Well, clearly, we felt that we would be seeing much of that response by this summer, before we even elevated our rate forecast beyond what we had earlier. We only had a modest further decline below the 1.6 million level in our previous forecast. As we have taken the mortgage rates up more, we have lowered the housing starts further. It's very difficult to say. As you noted, there are other influences at work, and there may still be some adjustment to the tax law changes. There are still some problems of high vacancy rates in home rental properties in various parts of the country. Again, when you look at house prices, there too, the evidence suggests that, at least in many markets, there's still a pretty robust demand at these interest rates. And there is just no anecdotal evidence to suggest to us that we are way off the mark in our assessment of demand positions. Even the survey information suggests pretty high numbers of people whose attitude is that this is a good time to buy a house. That may be surprising, but that seems to be the pattern.

MS. SEGER. The other question I have again ties into yesterday's briefing, and relates to our heavy reliance on the trade turnaround to produce a good 1988. If I'm reading the numbers right, about half of the real GNP growth, fourth quarter of 1987 to fourth quarter of 1988, is expected to come from improvement in net exports. Again, I think it's very, very difficult to get a $54 billion increase in exports in one year--namely, this year--and then tack on $57 billion next year. That's just a lot to produce.

MR. PRELL. One of the main comforts we can find in the numbers is that it looks to us like the trend in real exports has been quite strong thus far. And based on our exchange rate projection and the assumption that there are probably still lags in the order and delivery process, that means that some of the improvement in exports is still not fully evident. We think that we are forecasting, basically, a continuation of patterns that are already perceptible. In some respects, I think a greater concern, given our outlook, would be that we get both the improvement in the net exports somehow, and also get greater domestic demand growth. That puts still greater pressures on resources than some people would have thought in the past. We have two years now, in our forecast, of consumption growth that is really subpar historically. So, in a sense, we have these things put together in a way that gives you a rather smooth adjustment to the picture.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I don't have a question. I would just like to comment on the outlook.

CHAIRMAN GREENSPAN. Well, if you'll hold that for just a few minutes. President Parry.

MR. PARRY. I just want to raise an issue to shed a little light on this concern about a slowing in the interest-sensitive sectors of the economy, such as housing. It seems to me that with the economy operating where it is, in terms of employment at least, if we did not get that slowing in the interest-sensitive sectors of the economy at the same time we are going to get the strength in net exports, we would have a real problem. So, one can be concerned about the implications for housing or for other sectors but the picture doesn't really fit together very well if you don't get that kind of slump. And I would assume that's the problem.

MR. PRELL. That's what characterizes our outlook and I think some of the comments around the table suggest that there is a hopeful aspect of this--that everything falls nicely into place.

CHAIRMAN GREENSPAN. Mr. Melzer.

MR. MELZER. Mike, if this linkage between dollar weakness and inflationary expectations isn't broken, and you weren't able, for example, to achieve over the forecast period the 10 percent annual of decline in the dollar--let's just say that that becomes impossible--how would that affect the forecast in a broad sense? In other words, if you couldn't achieve some of the external adjustment through the foreign exchange price mechanism--

MR. PRELL. In other words, the dollar--I wasn't clear what--

MR. MELZER. What I'm saying is that the box we are in right now is that, as a practical matter, if we tolerate that dollar decline, it kicks off inflationary expectations. So, let's say that you just assumed that the dollar was stable. How would that affect the forecast?

MR. TRUMAN. It depends a bit, I think, on what else is going on at the same time. Much of the impetus to net exports from the dollar, at least as far as this forecast horizon goes, is what is already in train. Less than half of the increase next year in net exports is directly traceable to a further projected dollar decline. But, presumably, if you didn't have the dollar decline, then you wouldn't have the same kind of pressures on interest rates. So you would have less pressures in the interest-sensitive sectors of the economy. So you have some compensation in terms of the economy's operation as a whole which, in turn, would tend to feed back again on the net exports, so you would have less improvement in net exports too. But, there is a certain sense of [unintelligible] that is basically the way we think about this.

MR. HELLER. Wait a minute. You say that interest rates wouldn't be rising; but you can also come up with that scenario of a continued stable dollar that comes about because we are raising interest rates in this country. Then, how would your answer be different?

MR. TRUMAN. Under that scenario, maybe instead of a $50 billion change in net exports you would have something like $20-$25 billion. So you would have less than 1 percent of GNP in this forecast, and that's well within the error. Mike put it that way in the overall forecast.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I guess that was sort of what I was going to ask. One other question I had in mind: I'm not a big "aggregates person" but, in line with this whole issue of aggregate demand, it strikes me that this recent uptick in interest rates is going to have a further damping effect on the aggregates. I think that is fine, but at some point, you have to ask how much aggregate demand is plausible in that scenario. I think you are restraining it. You have to come up with some fairly implausible velocity growth numbers to get aggregate demand outside of a range that would present a real breakout in overall aggregate demand. It seems to me that we have it pretty well cornered here. In the long run, you could have a couple of bad quarters under that scenario but, given these recent moves in interest rates, what are we projecting on the broader monetary aggregates?

MR. KOHN. As you saw in the Bluebook, we are projecting that the rise in interest rates, which is not all that large but is significant, would damp growth in M2 over coming months.

MR. JOHNSON. You have about 4 percent.

MR. KOHN. If you abstract from September and you just have the fourth quarter. Now we have this August-to-December target. And then for next year, under the assumption of further moderate increases in interest rates, we would have M2 growth in the 4-1/2 to 5 percent kind of range. That implies--

MR. JOHNSON. Why would it pick up with higher interest rates?

MR. KOHN. Well, first of all, the rate of increase in interest rates may not be quite as great. And there are some things that seem to have been depressing M2 growth that we really couldn't account for this year and we are assuming that they won't be quite as active next year. For example, the IRAs won't be around, and that might boost M2 growth a little; so, we have this assumed pickup in growth next year. If that came about, with our GNP projection that would imply about a 2 percent increase in velocity. But, remember, we're damping domestic demand here; we have slower domestic demand than we have GNP, so if you look at velocity from that perspective, it wouldn't be quite as big an increase. That's not all that large an increase--

MR. JOHNSON. That's sort of what I'm getting at. You have it cornered a little, it seems to me.

CHAIRMAN GREENSPAN. Could I raise a question about what the GNP demand numbers would really look like if we were to recognize that the way we calculate the numbers is a function of the fact that we are using 1982 as a base period? I was looking at the fixed-weight GNP deflator versus the GNP deflator, which tends to pick up a difference in the mix, which is essentially an issue of how far we are from the base period to a large extent. If I were to deflate the nominal GNP by the fixed-weight index--which is roughly, but not quite, the equivalent of moving the 1982 base up to 1987, the current year--it seems as though we're getting a good deal less in the way of real growth. Let's take a case in point: the fourth-quarter over fourth-quarter change this year and next, with respect to the difference between the GNP deflator and the fixed-weight deflator, is .3 and .4, respectively. Assuming that the nominal is the same, that would reduce real growth. The problem I have with that, however, is that I'm not sure whether the model is generating the real first and then, by implication, the nominal, or vice versa. How do you look at that issue? In other words, how do we interpret that?

MR. PRELL. Well, it's difficult to dissect this precisely, but I think we are dealing mostly with a process that looks at the real first, infers from that the pressures on resources, which then feed back through a short-run Phillips curve relation to the wage and price side. That's a stylistic characterization.

CHAIRMAN GREENSPAN. Let's be very specific. In 1982, oil prices, and overall import prices, were much higher than they are now. Therefore, a rise in oil imports on the import side of real GNP is a larger subtraction with 1982 as a base than with 1987 as a base. I guess I'm really asking if you were to restructure the total system so that say, 1987, equals 100 instead of 1982, how would your real GNP look in that context?

Mr. TRUMAN. These two years, 1987 and 1988, oil imports don't rise very much. You may get some effect on GNP to the extent that you don't have the same rise in domestic production of oil or energy, measured in 1982 dollars. But there's not much subtraction, even in our forecast, from higher oil imports from fourth quarter to fourth quarter.

CHAIRMAN GREENSPAN. Also, assume that the overall non-oil import price deflator is significantly lower than it was in 1982, which, as I recall--

MR. TRUMAN. If I remember, it was just about 100; maybe I'm off by a few points. The non-oil price deflator was running about 100.3 in the second quarter.

CHAIRMAN GREENSPAN. Which means that it's a relative issue that the domestic thing is [unintelligible]?

MR. TRUMAN. Well, you would get some impact, I guess, from that.

CHAIRMAN GREENSPAN. The reason I raise the issue is that it's becoming a very crucial question, not of statistics, but for real evaluation here. We are trying to determine to what extent the net exports are the crucial issue. We are getting some signals out of the industrial production index. That is basically saying, if anything, that the cutting edge of the net export figures is much sharper, so to speak--much more positive--than the GNP numbers are implying, because we are getting extraordinary strength in industrial production. Do you read it that way? Or is that--

MR. TRUMAN. I don't know about extraordinary; maybe some of the comments earlier suggested that. One problem is that, to the extent you get this going on, you're producing things which, of course, you're shipping abroad; and you don't see it showing up in consumption and things like that. And that is part of the adjustment that President Boehne was talking about. You are not going through a recession actually, but you are going through a much slower growth in [economic] welfare, as measured in current consumption.

CHAIRMAN GREENSPAN. We could be building inventories for export, which affects the industrial production index but doesn't show up in the trade figures. I think implicit in all of this is that if the industrial production index stalls, it would raise some serious questions about this hypothesis.

MR. PRELL. I might just note that, while industrial production is growing much more rapidly than we think GNP is growing this quarter--and the IP numbers must be regarded as still quite tentative--that growth is well within the range of variation in that relationship. And for the year as a whole, the gap is rather moderate. So, at this point, we don't see a big disparity in the signals coming from the industrial sector or industrial production estimates and GNP, particularly when you start [unintelligible] GNP goods output that most reasonably can be compared in industrial production.

CHAIRMAN GREENSPAN. Any other questions for Mike before we go to the general comments? May I request that, in the general comments, you address one question that is bothering me particularly, and I think it's really crucial to the outlook. I would appreciate hearing any views you have on how to interpret the rise in long-term Treasury rates--that is, to what extent would you disaggregate the rise into inflation premiums, or expectations instability premiums, and what part do you perceive to be real? By expectations instability premiums I mean expectations that bond prices fluctuate so dramatically that, in fact, you're imposing a premium on the overall interest rate. It strikes me that much of what we are viewing out there, and how we view it, is going to depend to a very substantial extent on how we evaluate the various components in what is a fairly significant rise in the underlying bond rate. I think President Boehne wanted to open it up?

MR. BOEHNE. Let me just comment on the Philadelphia region. It continues to perform well above the national experience. New Jersey, Delaware and eastern Pennsylvania continue to have very low unemployment rates. As a matter of fact, I think that if there's a drag on growth in these areas, it is that there's a labor shortage and business firms simply can't keep up with production needs. Even the traditional manufacturing areas in our District are showing improvement, and unemployment is coming down in those areas as well. Both residential and nonresidential construction are very strong; retail sales are healthy, except for autos; loan growth is running about twice the national average; and real estate lending is growing about three times the national average. So, we have a rather bullish region that is being constrained mostly I think not by a lack of aggregate demand, but labor. The concern that I have picked up in the last couple of months, mostly in the business community, is a concern about inflation. And I think it's being triggered by these labor shortages that people report, particularly at the entry level. If you look at the help wanted ads in the newspapers, and just the help wanted signs generally, they are at pretty high levels. While wage increases have been reasonably moderate, I think a lot of people in the business community are concerned that this is just the kind of situation that triggers a wage-price kind of spiral.

On the national scene, I think the Greenbook numbers look reasonably good. In terms of the risks--and I am being influenced by where I sit and the people that I talk to--it seems to me that whatever risks there were of having too weak an economy, or even a recession out through 1988, have shrunk considerably. I see the risks now on the side of triggering some kind of a wage-price increase. There is one point, however, in the outlook that I think bears mentioning, and that is that both the fundamentals and the trade situation indicate a continuing downward movement in the value of the dollar. Indeed, this is reflected in the Greenbook forecast. We are in this "inflation/dollar" box, as you aptly put it a moment ago. But I think that fundamentals have a way of winning out, even over central bank policy. So, as we deal with these bouts of a falling dollar and falling bond prices, we have to bear in mind that this is really what we expect. We expect the dollar to go down. And I think we have to be careful that, as we deal with these episodes, we don't lose track of the fundamentals. That leads to the question that you posed, which is a very good question. I don't have an answer, but I have a suspicion that more of this increase in long rates is real than it is inflation. I say that because, if you look realistically at the fact that the U.S. is going to have to import lots of capital over the next several years, as we have the last several years, I think that calls for a certain premium over foreign interest rates. What we may be seeing here is some adjustment to what it takes to attract the kinds of funds that we need.

CHAIRMAN GREENSPAN. Thank you. President Parry.

MR. PARRY. Mr. Chairman, with regard to your question about real rates, we look at it in two different ways: first of all, through a model approach and, secondly, at the survey that is referred to as the Hoey survey from Drexel Burnham Lambert. Both of these give us a similar reading with regard to your question. In both of those instances, much of the increase in nominal rates has produced an increase in real rates. For example, the Hoey survey shows an increase of only two tenths of 1 percent in inflationary expectations between January and June. So, in effect, what we got was a very sharp increase in real bond rates when we saw bond rates increase so sharply in the April-May period. This has a big impact on our forecast--and I think also on the Board staff's forecast--because it does damp the growth of the interest-sensitive sectors of the economy. In some respects, I draw a little comfort from that because we also have strong growth in the net export area and, in effect, it is the weakness in the interest-sensitive sectors that makes room for this growth in net exports.

With regard to our forecast more generally, we estimate that real growth will average between 2-1/2 and 3 percent over the forecast period. We have actually shaded slightly our expectations with regard to net exports, but we still have real net exports contributing approximately 1 percent to real GNP growth, both this year and next year. Also, and here we have somewhat of a difference with the Greenbook forecast, we have greater strength in consumption in next year's economy than the Greenbook forecast. That has something to do with differences about the growth of real disposable income, if I'm not mistaken. We are concerned about the inflationary impact, not only of our own forecast but also that of the Greenbook. As you know, in the Greenbook forecast, inflation averages 4 to 4-1/2 percent, at least in terms of the fixed-weight deflator; and we are not much different from that. But what concerns us is that, in some respects, the composition of that inflation in our forecast changes rather dramatically. We are somewhere in a zone close to full employment, at least according to our staff work, and thus, in our forecast and in the Greenbook forecast as well, wage costs begin to accelerate. To the extent that the inflation in 1988 is more a function of what I would characterize as underlying factors and less a function of some of the temporary factors that we drew on this year, we think that the inflation problem will become more persistent. Finally, I do think that in some important respects, the risks to the outlook are on the upside with regard to real growth and perhaps in inflation as well. My primary concern here centers around government spending because I think that the assumption of the $25 billion cut used both by us and in the Greenbook may not materialize. And if it does not, then we are likely to get more strength from that sector than is included in our forecast. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. Mr. Corrigan.

VICE CHAIRMAN CORRIGAN. In terms of the forecast, it has been true for some time, and it's still true, that our staff work in New York has the same overall result as the Greenbook forecast but with an unchanged dollar and a slightly smaller adjustment in real net exports because we have a scattering of stronger elements of domestic demand, including inventories. So, while the aggregate numbers look very much the same, what lies beneath them is quite different insofar as the dollar and real net exports. Our inflation outlook, despite the fact that we have the dollar stable, is about the same, or maybe a shade worse than the Greenbook.

Mr. Boehne raised a question earlier in the discussion about this overall adjustment process that I'd like to comment on just briefly, and then turn back. I think, Ed, your question was: can it work? Or is the scale of the problem so big that you can't get from here to there? When you look at the big three countries--the United States, Germany, and Japan--the fact of the matter is that by conventional standards the adjustment is well underway in the sense that for both 1986 and 1987, and in our forecast for 1988, the growth in domestic demand in both Germany and Japan is stronger to significantly stronger than is the growth in their own GNP. In the case of the United States, we still had domestic demand stronger than GNP in 1986; but in 1987, and in our forecast and yours as well--although there are some differences there--you get a widening out such that GNP growth in the United States is something like a percentage point greater than growth in domestic demand. It is true that overall growth in Germany and Japan is perhaps lower than one would like to see. But, the dynamics of the adjustment have set in, in what I think is not an inconsequential way. Again, the evidence in all three of the major countries is basically working the way the textbook says it should. The problem, to some extent, is what Ed touched on earlier, and that is the scale of the adjustment that we are talking about and the scale of adjustment that is needed. When you look at it in terms of the behavior of exports--and this is all relevant to the outlook, I'm just getting there in a roundabout way--we all know these numbers are lousy, but the numbers for July 1987 versus July 1986 indicate that U.S. export growth really has been, I think we can say, almost spectacular. And it's not confined any more to a handful of products or a handful of countries; it's pretty much across the board, including very sharp increases in exports even to Japan. The strength of those export numbers in the context of the overall dynamics of the adjustment raises a couple of questions in my mind. What's offsetting it in part, of course, is imports. Our own imports are still very, very strong, across the board, with few exceptions--perhaps lumber. But, by and large, those imports are still humming and a lot of that is price. Then again, how many J curves do we have to see in terms of import prices? That's one of the reasons why I like our forecast--at least right now--better than I like the Board staff's forecast. But, when you put it together, it leads me to one or two possible conclusions. One is that there really is something systematically wrong with the trade numbers, at least as we see them month to month. The second is that the domestic economy is, in fact, stronger than we think it is, or at least than the conventional measures are telling us. My hunch is that probably both of those things are true: that the trade numbers are messed up and that the domestic economy, if anything, is actually a bit stronger than we think it is.

Partly for the reasons I've just noted, I would certainly join those who have already said that, in looking at the outlook at this point in time, the risks are decidedly on the upside. I find it hard at this point to ignore the galaxy of numbers in the business fixed investment areas, industrial production, orders, and labor markets. They all seem to be to pointing in that direction, in a context in which I really do believe that the margin of upside error, if you will, is really quite slim. I think you can now make a pretty good case that actual GNP is brushing up against potential GNP; labor markets, no matter how you look at them, have to be at least near the danger zone; and I think it's not hard to visualize at least some selective bottlenecks beginning to develop, for example, in nondurable goods areas where we already see that raw and intermediate material prices are rising. Now, we could get a little help. There is a faint chance, at least in the near term, that the oil price pressures could be downward rather than upward. That would be temporary, but that's possibly a favorable straw in the wind. But when I put it all together, it seems to me that both the global picture as well as what we can derive from our own situation statistically lead me to view that the risks are on the upside.

Now, on your question about the long-term Treasury rate, Mr. Chairman, I thought we were framing the question a little differently than maybe you were. I was prepared to answer this question: what do I think is driving the rate up? Is that what you are asking? I'm not sure it is the same.

CHAIRMAN GREENSPAN. The point is that, implicit in that, is the breakdown of the components.

VICE CHAIRMAN CORRIGAN. Well, the breakdown of the components to the increment and the breakdown of the components to the level may not be the same, though. But, let me try to answer.

CHAIRMAN GREENSPAN. Do both.

VICE CHAIRMAN CORRIGAN. If it were the increment in the nominal rate, which is the question I thought you were asking, I would put virtually none of that on volatility, which was the middle factor you raised. I would put the greater weight on inflation-related considerations, including the exchange rate of the dollar. But, I do think there is something real there too; I can't be very precise as to what. But I'd give zero weight on volatility, certainly.

CHAIRMAN GREENSPAN. So this is your increment?

VICE CHAIRMAN CORRIGAN. Yes.

CHAIRMAN GREENSPAN. It has been volatile; therefore, it can't be more volatile?

VICE CHAIRMAN CORRIGAN. Yes, but I would say that while I think the bulk of the increment has been driven by these inflation-related things, I also would say that the level of the real interest rate does come out higher. Maybe, just maybe, that's because there is something happening in terms of the marginal productivity of capital. It's possible.

CHAIRMAN GREENSPAN. But, it's almost impossible to tell at this time.

VICE CHAIRMAN CORRIGAN. No, I agree.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. With regard to our view of the economy and conditions in the District, I think what we are seeing is quite consistent with something like the Greenbook forecast. In general, economic conditions in the District are quite good and have been improving consistently for some time. The only areas I hear any reservations about have to do with residential construction, where reports have tended to be mediocre, and with loan demand, where bankers say there is no demand to speak of. Labor markets have tightened up a good deal, again, in general; but what is striking in that regard is that there is not any discernible increase in the rate at which salaries and wages are rising as yet. Apparently, at this point, people are just taking the strategy of not filling jobs or filling them more slowly than they otherwise would in this environment. With regard to your question about interest rates and so forth, I guess I would not have a definitive answer either, but I would start with the dollar. It seems to me that we sometimes talk as if all declines in the dollar are equal. I don't start with that position. It seems to me that it matters a heck of a lot why the dollar is falling. For example, if we had fiscal policy in a position where budget deficits were declining in a sustainable way over time, I might predict that real interest rates were going to decline sustainably and, therefore, the dollar might decline in that environment. I would say that would be fine; but I don't think that characterizes the current situation at all. I think we are in a situation where, in fact, the adjustment is unlikely to come through fiscal policy. Therefore, particularly in light of the June and July trade numbers, there are a lot of market participants who seem to feel the adjustment is going to have to come through other policy steps in this country. I think this is kind of what Mike and Ted Truman were talking about earlier--if you are going to get continued improvement in trade, that requires higher real rates here to damp residential construction, nonresidential construction, and so forth. Alternatively, of course, we may at some point get into the situation where we are not prepared for rates to rise in that fashion so that we sort of arrest the improvement in trade; that is, we get stronger domestic demand and stall the improvement in the trade balance. I think that's the kind of box we are in as long as we have the fiscal policy outlook that we have. That situation seems to me to be discouraging, as it has been for quite some time.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Thank you, Mr. Chairman. I would start with the region, by repeating what I said last month--that economic conditions in the Sixth District are really booming and seem to be strengthening. The reports that we're getting from our directors and from other business people are extremely positive at this point and very optimistic. And, it's fairly much across the board. For example, we are seeing increasing evidence of improvement in the tradeable goods areas, certainly in textiles. We are also getting improvement in apparel production. Paper production and chemicals also are doing a lot better, and I might say that paper and textile mills and factories are going just flat out at the moment in our area. We are now hearing about labor shortages, particularly in the textile areas, and there are some bottlenecks beginning to appear. For example, we have had reports of shipments of carpeting being delayed because of labor shortages. But having said that, at this point at least, we have not seen yet any pressures on wages, since labor seems to be moving from the slower-growth areas into the areas that are picking up. So far, the wage pressures have not followed, at least immediately, from the labor shortages. Even on the commercial structures side, we are seeing excess supplies of space being absorbed more rapidly, and that is particularly true in the fast growing states of Georgia, Florida, and Tennessee. Construction figures are up also. We are not only getting absorption; we are getting more construction, particularly in the hospital and warehouse operations. Rising mortgage rates have cut into the housing sector, particularly in the multifamily area. In Louisiana--I would single that out because we've had nothing but bad news for a couple of years in that area--we are beginning now to get some good news, marginally better news. The rig count is up and all of the oil and gas support services are beginning to come back on line.

Turning to the general forecast, our forecast for the last half of this year has strengthened a bit in comparison to what we had a month ago. Consumption seems to have picked up somewhat more than we had anticipated and we are seeing investment respond to higher plant utilization. Looking ahead to 1988, we are marginally lower than we were at the time of the last meeting, and just about in line with the Greenbook forecast. The only difference we have with the staff forecast is in the area of consumption which, of course, I've mentioned a couple of times before. And, as I indicated earlier, we don't see quite the level of improvement in net exports that the staff is seeing. But when you net that out, we are pretty close for 1988. Also, I think it is significant, as far as our forecast is concerned, that we did not build into the forecast any tightening of monetary policy, which apparently the staff did. On the price side, again, we're pretty close to the Greenbook forecast. So, when I put all this together, Mr. Chairman, it seems to me that the forecast is reasonable and even a little optimistic. And I would agree with those who would put the risk on the upside rather than the downside.

Now with respect to your question, I think there are probably ingredients of both. At least from where I sit, there is some inflationary expectation in these higher rates, but to a large extent, I think they are real. But having said that, it seems to me from the few market participants that I've talked to, that there may be an element of irrationality in the way the market is reacting. The reactions to even minor declines in the value of the dollar are producing higher rates than might have been called for. I don't know how to assess this, really; I'm just talking to a few people in the market who are sitting in Atlanta and who have made this comment. They are saying, and I think there may be some validity to it, that there may be some over-reaction, although some other factors are involved. Now, if that's true, I think the policy implication is upon us, because they are going to be reacting perhaps adversely to the trade numbers for August, which probably will not be very good. We have just done some work which would indicate that the seasonal factors that are present in July are probably present in August as well. So, we may get some equally bad trade numbers. And, as the Gramm-Rudman fiscal policy debate goes on in the Congress and we don't get anything out of that, I think there's going to be a reaction in the bond market as well. It seems to me that the market is looking for every snippet of bad news that it can find and reacting to that, rather than trying to find something positive in the scenario.

CHAIRMAN GREENSPAN. Thank you. President Keehn.

MR. KEEHN. Thank you, Mr. Chairman. From a national perspective, our forecast is really very consistent with the staff forecast. I would say that we have been a little higher throughout the year and, therefore, the last revision by the staff brings it pretty much in line with our perspective.

With regard to the District, whereas we have been a laggard throughout this recovery, certainly, at this point we have turned around. The conditions and the trends in the District I think are very favorable. Employment, for example, is very consistent with the national numbers. Our unemployment is still higher than the national average, but I do think the employment numbers are coming along quite well.

I thought I would comment on just a couple of industries that are important to the District that I think are going through an interesting and positive adjustment. First, the steel industry is a very dramatic example of a shift that is taking place in a very troubled industry: We have had in the Midwest just a whole host of closings, bankruptcies, and near-bankruptcies, and, in addition, some shutdown of capacity; but those who have survived and those who have put some money into the plants, and have modernized them, certainly at this point are doing very well. The decline in the dollar and the import restrictions have helped tremendously, but the demand for domestic steel is strong, and as a consequence, the plants are operating at a much better rate. The demand for steel products seems to be quite broadly based, and now is as strong as any time since 1981. In getting to a point you raised earlier, many of these products are on allocation; the delivery times are clearly moving up from eight to nine weeks, so there is a slowdown in the delivery process. The service centers, as I understand it, are trying to build inventories but are not able to do it; inventory is going out as fast as it comes in. And, not surprisingly, there is something of a price increase going on in the industry and the price increases for the first time in this cycle may really seem to be sticking. A tangible sign of an improvement in this industry in the last six or eight months is that we've had an announcement of two new steel plants in Indiana: one a joint venture with a Japanese company, which is quite a significant installation; and the second a stand-alone facility.

VICE CHAIRMAN CORRIGAN. These are both [unintelligible] integrated plants?

MR. KEEHN. No, the Japanese one, I think, is fairly specialized; but they are brand new plants centrally located.

CHAIRMAN GREENSPAN. Cold-rolling operations? Or importing slab?

MR. KEEHN. No, not importing--they are taking slab out of a Chicago mill and cold-rolling it in Indiana. So, I do think it's an industry that has gone through a tremendous transition. The other industry that is important to the District is heavy duty trucks--Class 8 trucks. Sales this year, I think, are going to be 13 or 14 percent higher than last year, and the outlook for next year is another increase of 3 to 4 percent. These will go up to 125,000 to 130,000 units and this is just a lot higher than what we were experiencing three or four years ago. There is still a lot of capacity in that manufacturing process but, nevertheless, this is a business that seems to have gotten better. Pricing is still tough, however. Nevertheless, from the District's perspective, it has been good.

Let me say a quick word about agriculture by adding a little to what I've said in the past: namely, conditions seem to have stabilized, albeit at low levels. Land values are beginning to move; transactions are higher, and in a couple of instances, significantly higher. But, the point I'd make on what I find to be a new development is that general business conditions, not just agricultural conditions, in the area of Iowa seem to be better.

Turning to the price issue, I must say that I find this a very, very difficult read. I keep hearing about price increases; I've commented on steel, but specialized chemicals, paper, paper products, brass, and copper all seem to be moving up in price. They don't show up yet in the CPI numbers. The competitive conditions for finished products are very tough and people are being squeezed on margins; but, at some point, you just have to think that this is going to poke through. On the wage side, I'd add to the comments that we are hearing about shortages. We were up in Michigan the other day doing a presentation and some of the people were commenting that they just can't get enough people to work in some of the operations there. I would think that, at some point, we are going to see something of an increase on wage rates that's beyond what we've had over the last year or so.

Turning then, Mr. Chairman, to your question on long-term rates, which is a very, very key issue, like Jerry, I think it is awfully hard to analyze each part. But, I think that the underlying rate of economic activity here is pretty good; it may be a little more rapid than we expected and, therefore, there may be some real pressure on rates. Also--and I can't analyze what part equals what--on the inflation side, I think there is growing skepticism out there; there is concern about inflation, and something in the rate increase that we have experienced certainly has to relate to that. Thank you.

CHAIRMAN GREENSPAN. Thank you. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, I guess it's somebody's turn to say something not quite as positive as we have been hearing. I guess it falls to my lot, being from the Eleventh District. I would characterize our economy in the Eleventh District as still somewhat sluggish and a little fragile, although there have been tentative signs of improvement. Businesses around the District that serve a national or international market all seem to be saying that they are seeing some improvement. These would be primarily in electronics, livestock, chemicals, and defense. There is a little more optimism there. The businesses that serve their own local area or region, though, say that their business remains flat; they really have not seen any signs of improvement. Obviously, there is a correlation in attitudes and sentiment related to oil prices, since oil is so important in our region. With the improvement there, and with the increase in the oil rig count and additional activity going on, there is more optimism. There is a little more activity in related businesses; all but construction-related manufacturing are growing. Agriculture is stabilizing, and cotton and livestock farming are doing fairly well. Our retail sales remain fairly flat. We continue to worry somewhat about the condition of our financial institutions. Pick up a newspaper and you'll still find reports of foreclosures and bankruptcies continuing. Last week in Austin, which was really the bright spot for the last several years in Texas, there was the posting of a foreclosure of a fairly major hotel-office complex that was pretty new. There were foreclosure postings in Houston, also, of two or three fairly well known good projects. This doesn't mean the foreclosures will actually occur; the postings could be part of a renegotiation. Nevertheless, it is upsetting. We saw a report last week that Dallas had lost 40,000 jobs over the last year. That seems awfully high to me, but those are the kinds of reports we are hearing. Though we hope that we are on a comeback trail--and, if oil prices hold, I think we will be--I don't think we have seen the bottom of our commercial real estate problem. I think we probably are going to be worrying about that for at least two years, possibly three, before we can work through that.

On the national picture, and possibly I'm somewhat influenced by our own Eleventh District, we would come out--looking out through the rest of this year to 1988--a little below where the Greenbook is this time. Although we moved our own forecast up slightly, we didn't come as far as the Board staff has in the Greenbook. On the long-term rate, I don't know that I have any particularly useful insight into that except that the evident concern about inflation does not seem to be quite as deep among the people I've talked to; certainly, in our District, there is not really [unintelligible] to the problem.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I'm afraid I owe some apology for having discussed my thoughts on the state of the U.S. economy at a time you wanted to consign to questions. So let me just address that last question you posed as best I can, which is not very well. I think you have to look at the negative correlation we have had between exchange rates and long-term interest rates since the fall of 1986 to get an answer to that. There are three possible explanations: one is that this has resulted from still a third factor, which is the rise in inflationary expectations. A second--and maybe the most popular explanation of it--is that this decline in the dollar rate has been a decline in the real rate because of the persistently larger trade deficits that we have had, and fears that this will be reflected in higher import prices, which also will spill over into the prices of goods from those industries that compete with imports. And the third explanation is that the rates may be high because the market is responding to what it thinks we are likely to do; but if that is the case, tightening would clearly be inappropriate because that would mean, I think, that a large part of that was real. My impression has been that there really hasn't been that much response at the long end to actions that we have taken. For example, the response to what I thought was a very strong statement via the discount rate increase and also the raising of the borrowed reserve level was big at the short end; but we didn't really have all that much response at the long end. So, that suggests to me that some part of this is probably real. I guess I would end up with a view along the lines that Jerry first outlined, and some others have endorsed, that part of this is real and part of this is inflationary expectations. I don't know what the mix is and I guess nobody else does. But, I believe both factors are at work, I'm afraid.

CHAIRMAN GREENSPAN. I wish we knew the answer to this.

MR. BLACK. I do too.

CHAIRMAN GREENSPAN. Vice President Hendricks.

MR. HENDRICKS. I like the comments made by Ed Boehne. We are experiencing a bullish feeling with respect to business in our District. I'm really not sure how much significance, if any, should be placed on this observation but, at a recent meeting of our directors we did notice for the first time, perhaps, some concern about risk on longer-term loans, and some adjustments in their basic lending policies, at the margin.

With respect to our outlook, it's quite similar to the staff's Greenbook forecast, but we still continue to see the consumer in a stronger spending pattern than indicated by the staff. We also see housing as less of a drag on the economy. We don't believe exports are going to be quite as strong as projected in the Greenbook. Despite the sectoral differences in the projections, we come out at about the same place, with real GNP growing at about the same pace as the forecast in the Greenbook. We would see that, however, being accompanied by some pretty strong wage and price pressures.

With respect to your question, I don't know how much I can add on that, but recent changes in the rates do appear to us to be related to the rate of interest [needed] to attract foreign savings. We believe that some of the earlier increases that we saw might have been tied more closely to inflation.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. First of all, I would say that over the last year or so, performance in our District has been somewhat stronger than the national average. Employment has been about in line, retail sales somewhat stronger, and I guess the most notable area of strength has been construction, both residential and nonresidential. Over the last couple of months, I would say things have slowed a bit, relatively speaking. We haven't kept pace with the employment gains nationally either in non-ag employment or manufacturing employment. Retail sales have held up well, relatively speaking. Residential construction is in line with the national averages and nonresidential is still somewhat stronger but growing at a much slower pace than it was. Anecdotally, we've picked up some evidence of the same thing that has been mentioned around the table today in terms of labor shortages. There was a company with about 90 semi-skilled employees that was shut down, and another big employer in St. Louis in town expected to pick up, I don't know, somewhere on the order of a third to a half of them. It ended up getting only five of them, because there were so many other people bidding. You hear that in other areas as well. One other thing I've heard in that regard is that companies that have generally been stable in terms of employment, or maybe even reducing employment here, recently have added employees. There are some noises about trying to negotiate some of the give-backs that were obtained over the last couple of years. I've heard just one example of that; it's not widespread.

On the broader outlook, while I have been, and continue to be, in agreement with putting the priority on price stability versus growth, the projections that come out of our Bank, which are based on money-driven models, have been showing for some time--and I thought I would mention it this month--the risk of a sharp slowdown in the economy in 1988 and even the possibility of a recession. Given the behavior of velocity and so forth, I think it is hard to evaluate this exactly, but one of the things that people continue to feel reasonably strongly about is the effect of a sharp slowing in money in relation to trend, if it is sustained for two or more quarters. And, it's really on that basis that we come up with this forecast. So, that's a very different view than previously expressed. I think it's difficult to evaluate because you can't know the effect of all the liquidity that was put in over the last couple of years, and whether that might continue to have a stimulative effect looking forward.

One last point on the interest rate question: I suspect it's a combination of an increase in inflationary expectations and some increase in the real rate. The only other thing I would mention that hasn't already been mentioned is that we are at, or have passed through, a major inflection point in terms of the interest rate outlook that's internalized in, say, the minds of traders and so forth; and people I would say, as we do, just follow markets quite closely, very quickly. But, in terms of broad-based behavior, I think that really gets built into prices over a surprisingly long period of time. I think one of the things we are seeing here is people continuing to adjust portfolios to a different interest rate outlook, and probably thinner participation in the market, at least on the buying side, by final investors. So, I think there's a certain element of uncertainty associated with this adjustment phenomenon.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. In regard to long bond rates, I think what we are seeing has something to do with the development of an exchange rate policy that no one thought out that carefully ahead of time. It's unfortunate that there can't be some median ground between recognizing that monetary policy needs to be adjusted to take into consideration foreign exchange developments and trying to pinpoint and draw lines in the sand in regard to foreign exchange rates. If we had been willing to make monetary policy adjustments before we drew the lines in the sand, we probably would have avoided some of the difficulties we are now in. Nevertheless, the line got drawn in the sand. And when that happens, it is very difficult to unhitch during a period in which inflation expectations are on the increase--particularly, I think, when you have some commodity price pressures that would require stable exchange rates in order not to have commodity prices rise. So, in that environment, it seems to me that long bond buyers are mainly anticipating what monetary policy and future short-term rates are going to be, and it's kind of a win-win situation from their perspective, because they think that we might have to raise rates to support [the dollar in] foreign exchange markets or we might have to raise rates to resist inflation; and either one works in the same way. Second, I think the long bond prices are affected today more strongly than they were ten years ago by a kind of speculative cycle. That is, at one point in time, long bond buyers really intended to keep the bonds. But we have developed an environment in which we have investors and fund managers whose success is based upon their performance; and there are times when it doesn't pay to be owners of bonds and, consequently, you're going to have long bond rates move a little too far. In some ways, it doesn't bother me to see long-term interest rates high. I think it would bother the U.S. Congress. I hope it would bother them, and I hope it would indicate to them how much opportunity there is to help there by controlling spending.

In regard to the Greenbook forecast, I really have no significant disagreement over the 1987 forecast. The staff has been lowering their inflation rates for the second half of 1987, so I don't see much disagreement there. I do have three areas of difference in regard to the 1988 forecast. I disagree, I guess, with Martha and some others who took one position with regard to real exports. I'm taking another position: I believe real exports will maintain a longer sustained growth path than is assumed in the forecast. I believe that we have many producers in the United States who have never learned to be involved in international markets. But once the United States became such a huge importer, we began to change the whole nature of the opportunities that exist. So, we have many, many small and medium-size businesses that have never taken that international market seriously, and now they are learning that they do have to compete in international marketplaces at home and abroad. And so I think we have a long learning curve involved here. We have a lot of financial institutions that have not done very well with regard to recognizing export lending. But I think that learning curve also will occur. Therefore, I expect that these present exchange rates will give us a wonderful opportunity for a long period of export increases.

As for my second disagreement with the 1988 forecast--and I know that Mike, or maybe Ted, mentioned the GNP deflator and its strange behavior--I would point out the staff's numbers on the CPI. In July, the staff had forecast a 60 basis point increase in the CPI from the third quarter of 1987 to the fourth quarter of 1988. Now they are projecting a 150 basis points increase in the CPI. Now, that really is making things get worse rather rapidly. I think that's not likely, first of all, because businesses have found that the environment is one in which you do not make profits by being able to increase your prices but you do it by learning to control costs. So, I think we are in a different environment than we were. Second, we have already gone through the big oil price increase, which the staff is telling us should have occurred earlier. About the second half of 1987 is when it should hit us, and I think that has kind of passed us. Third, I think foreign exchange rates are not likely to fall by the amount [indicated in the forecast], because I would presume that the majority of this Committee would not believe that the inflation forecast that we have is acceptable and they would be willing to take the steps that are necessary to not have those inflation rates materialize. Consequently, the dollar should behave quite well in that environment.

The third disagreement [with the forecast] is in regard to tax receipts. I think everyone is underestimating the effects of the Tax Reform Act, which is our first tax reform act since 1963. It is the first time we have broadened the base while decreasing the rates. All the evidence shows that the tax receipts are coming in higher than anticipated. We are going to have tax receipts that are going to be the largest percent of GNP in any peace-time year in our history. Not all that goes away with the one-time capital gains move, so I am somewhat optimistic in that regard. I am certainly willing to take whatever steps are necessary to make certain that the forecast for 1988 isn't correct because, if it is, then it is absolutely essential that we have policies that would lead to a tremendous slowdown in this economy.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I will try to be very brief in view of the coffee being outside! With respect to the Tenth District, we do see some very, very modest recovery. Looking at various sectors of the economy, starting with agriculture: commodity prices are up; red meat prices are very good; government transfer payments are outstanding; and, as a result, there is some comfort in the agricultural sector--or at least among those who are still in the sector. Lastly, I would say that our most recent survey indicates that agricultural land prices have stabilized, and there is a modest uptick in those prices as well. So, agriculture, from a very low level, has a good outlook for the rest of 1987 and quite likely in 1988, depending upon what the farm subsidy program will be in 1988. When you look at energy, the same is true: from a very, very low base it looks a bit better. In July, for example, there were 373 rigs working in the Tenth District as opposed to [unintelligible] in June. That's not much of an uptick, to be sure, and it is only 20 percent of the level that was achieved in 1982, which was the peak of the energy boom. So, it is still at a very low level. [Unintelligible] supporting a bit. Commercial real estate has been very depressed in Denver, Oklahoma City, and Tulsa--those areas that built on expectations [generated by] the energy and agricultural booms back in the early 1980s, inflationary expectations, [unintelligible]. There is a very slow absorption rate of some very nice and new commercial structures. In the Kansas City area there has been some damping in commercial construction, but nonetheless, it still looks very prosperous. In some areas, there has been a bit of damping in residential starts and sales, but activity is still above a year ago throughout the District in the aggregate. One last point that I would make with respect to economic activity in the District would be on the manufacturing sector: the automobile industry is not working at full production and, as a matter of fact, there continue to be layoffs in plants, particularly in the Kansas City area, in the GM plants specifically. There has been a bit of light at the end of the tunnel in the aircraft industry in the sense that sales most recently have been up in dollar volume but down in unit sales, largely because the sales are of jet aircraft as opposed to the smaller units.

Let me just address, then, our view of the staff forecast. They are a bit more bullish than we are. We look for about 2-3/4 percent growth not only for the remainder of 1987 but into 1988. In trying to look at their forecast in relation to our numbers, I believe the difference is that they have a buildup in inventories in the fourth quarter that goes out into 1988. That may be the difference in their forecast and ours, but it is such a modest difference that I don't think there would be a lot to argue about. To be perfectly honest, I hope their forecast occurs. I don't feel there is much risk on the upside, however, of this getting away from us.

Lastly, as to your question on long-term bond rates, I suspect it is a part of all three of the things that have been mentioned. I guess I would come out on the side of giving more weight to the view that it is an increase in real rates necessary to attract funds to support this federal budget deficit as opposed to just inflationary expectations. The uncertainty created by all of this largely accounts for it; how you disaggregate it, I don't know.

CHAIRMAN GREENSPAN. Vice President Eisenmenger.

MR. EISENMENGER. Turning first to the regional economy, we may have the strongest regional economy in the nation, and I think a good monetary policy for the New England region would be an alternative D. When you get together with our businessmen, all they can talk about is the labor problem--that they can't get the labor they need. We hear scattered reports that people are spinning off their operations in eastern Massachusetts or Connecticut and putting them in the depressed areas of northern Maine, or they are talking about putting them in other parts of the country. They are not moving their entire operation, but are moving pieces of it. However, I don't think New England is typical. We have an overall unemployment rate of 3 percent, and in New Hampshire, it is 2.2 percent. And that is not typical of the nation, which is 6 percent. So, you can't really look at the world through our eyes.

In our view, the Greenbook forecast for the U.S. economy in the next 15 months is almost the ideal scenario. If we have a sufficient guiding system to accomplish what that forecast suggests, that is almost as good as we can expect, considering the constraints. It is showing a real growth rate of something like 2-1/2 percent with the overall employment rates and capacity utilization rates only slightly different than they are now, which would suggest we would have only this minor uptick in inflation next year. And that is an ideal scenario. So the question is: Can we get there? At least as we read it, there is not much risk on the downside any more. The new orders that are coming in, the industrial production statistics, and the probable greater strength from foreign orders, suggest that the dangers of a recession, at least in the next 18 months, are pretty well washed away. On the upside--the possibility of having something faster than a 2-1/2 percent real growth rate--we have set in train two actions just in the last 25 days which provide us some insurance [against that]. And the staff talks about additional actions during the next year that--it is our best guess--would provide additional insurance. Our hope is that we can achieve the forecast that the Greenbook so optimistically puts forward. I don't think I have anything to contribute to what other people have said on the long-term bond rate.

MR. JOHNSON. What has the regional inflation rate been doing in New England?

MR. EISEMENGER. Well, wage rates are moving up faster.

MR. JOHNSON. But overall, I mean the broader--

MR. EISENMENGER. Well, you would have to talk about pieces. If you talk about the price of housing, we used to be--

MR. JOHNSON. The Boston CPI?

MR. EISENMENGER. When you talk about rental housing, it doesn't show up that much. But, in fact, when you're trying to bring in professional people, you can't do it. All the businessmen we talked to say they can't bring in anybody to buy a shack that costs $250,000; so there is no labor mobility in view of the housing shortage. Eventually, we will not have that housing shortage, as we didn't have it in the long run in California. It may be three years away. So there is not much mobility, despite the fact that we pay somewhat higher wages, because the real cost of living for someone moving in and buying a house is almost impossible.

MR. JOHNSON. Well, I agree with most of the discussion on the economy. It has been covered pretty well. I do think the economy has clearly picked up strength, and there is very little downside [risk] in the economy now. It is clearly in an expansion phase at a higher level than it was on before, but there's still an outstanding question--we've already discussed this and Mike went over it very well--as to how much of this is production-generated by the external economy and inventory building versus an overall expansion in aggregate demand. I think that is the key to what we would have to do on the monetary policy side. As I said earlier, I think that a lot of this seems to be trade-related. Some of it is not. I think there has been a buildup in inflationary expectations. I am fairly pleased at the moves we have taken; I think they were proper and should have the effect of eventually moderating aggregate demand to a level consistent with the forecast. Now, we are hedging against the plausibility of what kind of velocity number you could expect to go with those aggregates. Like I say, I think we are close to having the thing cornered. The lags are long; we may have to go through a few quarters of some pressure before we see the other side of that. But, I don't see a lot of room for nominal GNP under the kind of monetary policy we have now. The numbers don't seem to add up, except for maybe a couple of exceptional quarters, in the short run. A couple of other points I think are interesting: in spite of our concerns about the trade situation and the deficit--and I agree those are the major fundamental concerns--we seem to pass over those large deficit items. I think that's because we are concerned more about the longer run; but we pass over the really tremendous improvement in the budget deficit this fiscal year over the last fiscal year, without a dime's improvement in the current account. The amount of pressure that has been taken off has to be relatively substantial. We have gotten no real reduction in the current account and a $60 billion dollar reduction in the federal budget deficit. That has to be an important factor. Now, whether that continues is another matter. I think that is the question. But, if anything, we have relieved pressures on the capital import side. Maybe we are making up that difference on the domestic growth side and the demands of government are shifting more toward the private sector. But we have seen the dollar come down and we probably have seen net capital outflows.

In terms of the question of long-term interest rates, I tend to think that what has happened is mostly inflationary expectations. I think long rates have gone up primarily due to that. My personal opinion is they probably overshot, and eventually things will settle back down a little in the market. As I said, the flattening of the yield curve from our discount rate change was somewhat comforting: even though we didn't actually see a decline in long rates, we did see a flattening. I don't see anything out there that would push up the real rate dramatically. I think some of that inflationary expectation--I really don't know how much--is sort of a risk premium, but that could be put in the inflation expectations category. I don't see anything that shocked the cost of capital that would, in a way, raise the real interest rate. In other words, I don't see anything that has improved real returns on capital investment dramatically. If anything, the repeal of the investment tax credit in the tax bill has reduced returns on equipment; and there probably has been an improvement in terms of inventories because of the lower corporate rate; but, overall, I don't see any big shock to the cost of capital. So, I think it is mainly inflationary expectations and, hopefully, it will run off over time.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. I still think the hallmark of the recovery is really a better balance in the economy as a whole. The sectors that have been strong in the past are not growing quite as rapidly, or are actually shrinking, and I think that is something that we should keep in mind. If you look, for instance, at the projections in the Greenbook for 1987 and 1988, you still see quite a few minus signs. Durables are contracting this year at a 2.3 percent rate; nondurables are only up 0.8 percent; nonresidential structures are -2.7 percent; residential structures are -5.5 percent; and federal spending is -3.2 percent. So, there are quite a few sectors that are certainly not characterized by boom conditions, while others like agricultural, business equipment, and so on, are doing quite well. As a result, you get that better balance. Also, as many speakers pointed out, the great improvement in federal revenues, together with the restrained federal spending, really does a lot on the fiscal deficit side and brings a better balance on that score. I think it would be a mistake to hold up the dollar with further tightening of monetary policy, because we would be inviting a slowdown in those sectors that, at the moment, are really carrying the economy: real estate would be further depressed, and the capital sector would slow down. And, we also need the exchange rate change that is projected in the Greenbook in order to get that improvement in the trade balance that we are all hoping for.

Turning to the the long-term bond question, I agree with most of the things that have been said before, but let me add one additional factor. If you look at the increase in interest rates that we have had over the last year, you see that there were noticeably sharper increases in the long-term Treasury bonds than in long-term mortgage bonds and long-term corporate bonds. I would put a lot of that, which amounts to 50 to 100 basis points, at the door of the many debt moratoriums that we have had, or the nonrenewal of the debt ceilings, in the last five months. I think there have been four of those episodes; and that certainly must have a chilling effect, particularly on foreign investors who are looking at the United States with a jaundiced eye and putting us in the same league with countries that can't service their debt. So, that certainly has been a factor contributing to higher long-term Treasury rates in addition to the real increase and the high inflationary premium we have had.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. In a prior life, I worked with corporate planning, so I was just sitting here thinking of that in our discussion this morning. First of all, when you work with corporate planning, your bosses are always challenging your forecasts and they will not allow--at least mine didn't allow--you to utilize a single forecast. Or, if you did, they were always wondering about where the weaknesses were and whether or not something might hit them that would put them out of business. You are not allowed to bet the bank, or bet the company, on forecasts. So, I just wanted to mention a couple of things that I think we have to look at as we look ahead. One that I sort of hinted at it earlier is whether or not we are sufficiently incorporating the interest moves we have already had into this forecast. And if we are, are we incorporating the interest moves that we expect are yet to come? Also, there's the question: what if the dollar does not, in fact, decline more? So much of 1988 depends upon the trade turnaround; and if we think a weaker dollar is needed to produce at least part of that, then I think that is a vulnerability in this forecast. Also, and this has been mentioned by Wayne Angell and Bob Heller, I really think we are not paying much attention to the change in fiscal policy. When you go from a $221 billion deficit to $160 billion--and I've heard this morning that it might even come in below $150 billion--that's a major change from one year to the next. I am not necessarily a Keynesian, but I do think there is such a thing as fiscal policy, and it certainly works with a lag. I remember the summer of 1984, sitting around this table with many of the people who are here today, and it was very easy then to simply project the trends of early 1984, which looked tremendously strong. And, frankly, we missed the fact that business was going to slow down; just about the time we thought it was looking most terrific was when we got the 90-degree turn. I hope we are not doing that today.

On the interest rate question, because I am an old lady I remember being in financial markets before inflation was a big deal, mainly in the 1960s. And interest rates moved up; one of the reasons that long governments moved up involved simply the volume of financing, which is, of course, tied to the deficit. And, as Bob Heller said, recently we have had these problems with bumping up against the debt ceiling and postponements of auctions. Then, all of a sudden, Congress gets religion and takes care of this, and you get five auctions pushed through in a very short period of time, and this jerks things around. And yet, if no one was talking about inflation, I think that would happen. It certainly happened in August. It's probably going to happen again in the next couple of weeks. Also, there is just uncertainty about what's going on, uncertainty about what we are doing here. I think we could help that problem if we released the minutes earlier so that people would not have to analyze every tea leaf to try to figure out what we're up to. I think that contributes to this situation. Also, there has been improvement in communications and information flow. If you go back to the 1960s and 1970s, not every person around America and around the world had a CRT on his or her desk. Now every gunslinger sits there and, whereas they used to be told that the one thing to watch was M1, now they have been told that the one thing to watch is the relationship between the dollar and the yen or the dollar and the mark in the foreign exchange markets. Most of these people are not economists; they are traders; and you give them two easy pieces of guidance and that is what they trade on. So they contribute to this instability, I think, as you get this transmission from the exchange market into the bond market with the speed of light almost. There are just a lot more players and I don't think they are necessarily really weighing what's going on in the real economy; and neither do I think that they are doing a thorough analysis of the inflationary forces at work or not at work.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Thank you, Mr. Chairman. It seems to me, as I've listened to the comments made around the table this morning, that there's a very, very strong centralizing character to the projections that have been made by everyone--the Greenbook and the District forecasts. I think that they constitute, in their aggregate wisdom, a very responsible and good forecast; and I accept it. I would like to make this comment: the projections arise, as they must, from conventional economic analysis and historical experience; and I would like to suggest that maybe we should be a little open and alert to the possibility that there are some unconventional and untraditional things going on. Standing back from the trees and looking at the forest, I observe that we are about to end the fifth year of what has been called a recovery. I'm not sure how long you call something a recovery, but this one is going to be five years old in another couple of months; and I note that at the end of the fifth year the economy is, in fact, accelerating and inflation is declining by most measures. Inflation is projected to increase for some very good reasons, but right now you've got an economy that is accelerating and inflation that is decreasing--which is pretty unconventional. Industrial production is going up at an accelerating rate; unemployment has been dropping very strongly and is probably now somewhere near its natural rate. And yet, at the same time, we are seeing very, very small increases in the unit costs of production and a very flat producer price index. In fact, last month, the PPI was zero. That seems to be a little unconventional and untraditional. On the trade balance and the J curve, we are not getting the effects that would have been expected. They are stretching out; we still think they are going to be there, but that has been behaving unconventionally. Governor Johnson noted a few moments ago the fact that we have taken $60 billion of fiscal stimulus out of the economy, and yet none out of the trade deficit. And I think a lot of people would have been surprised ahead of time that those two things could have coexisted. Incidentally, as the economy is accelerating its growth rate, that is occurring while $60 billion of fiscal stimulus is, in fact, coming out of the economy.

I would suggest the possibility that inflation may behave in an untraditional way also. Maybe that also will stretch out and not accelerate. I ask myself: What possibility is there that could occur? I see several possibilities. They are all soft, and I would hate to have to try to defend any of them. But, for one thing, I suspect that we may be undermeasuring our productivity increase. We may be doing better than we know. I've talked to Mike Prell and some others about this some. I think we have a much higher level of mobility in this economy that is helping us deal with imbalances as they show up, rather than just suffer from them. For instance, instead of just accepting higher wage costs in Boston, we are moving plants to the rural regions of New England where wage costs are lower. That's mobility. A lot of bankers who are out of business in Texas are going to places where the banking system is stronger. That's mobility. There's a lot of that going on and that didn't used to be there. I think we may be in an era of very intense competition from several different respects. For one, the U.S. is back. I think that our industry is waking up and beginning to compete. Governor Angell spoke about that a few minutes ago and I agree with him. Also, there are many more serious competitors in the world economy than just a few years ago. They are serious and they are fierce, and I think that is one thing that is going to tend to impede the advance of inflation. I spoke at the last meeting of this group about what seem to me to be basic long-running, underlying deflationary tendencies in the world economy. I won't go back over that ground but I do think they are still there. All this is to say that I would not quarrel with the projection that we have over the next five quarters, but I'd like to pique a little interest maybe--on the part of some of the research directors around here, and some others, who are far better at this sort of analysis than I am--to see whether or not there are some discontinuities going on that could be favorable discontinuities. And, I think we should be open to those sorts of possibilities and alert to them. Meanwhile, I think we definitely have to be ready to deal with these inflationary expectations and not let that genie out of the bottle unnecessarily. Thank you, sir.

CHAIRMAN GREENSPAN. Thank you, Governor. Now let's move on to Don Kohn.

MR. KOHN. Thank you, Mr. Chairman. As it turns out, and with no coordination ahead of time, I swear, the initial part of my briefing will deal with the question you asked and the answer will have no more precision than any [unintelligible]. And then I want to go on and talk about perhaps some of the implications of any increase in the interest rates. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Thank you very much. I think it's almost dinner time, so let's break for coffee!

[Coffee break]

CHAIRMAN GREENSPAN. Well, we better get back to the agenda. As to the general discussion, I find myself probably about in the middle of much of what I have been listening to. The point I would make at the moment is this: while the economy is clearly quite strong, I think the orders pattern and all the various elements we usually look at are fairly balanced; to a certain extent the outlook is being given to us far more concretely than it usually is. This is more classic than one realizes. I grant what Mike Kelley is saying: that there is something different. There is always something different; something that does not look like all the previous ones. There is never anything identical, and it is always a puzzlement. But there is nothing very unusual about this one. And, it seems to have fairly good momentum. The main issue, however, which I think Governor Angell mentioned, is that we do not yet have any evidence of actual inflation. By that I mean as distinct from expected indicators. The numbers really are remarkably soft. While we can anticipate the elements of labor tightening--and I think it is probably quite correct to say that we would expect wage acceleration to occur and labor costs to run up--that has not yet happened. And what that suggests to me is that, while we are tight and are likely to get tighter, we haven't yet triggered anything. I think that the time frame in which these events will occur is often somewhat difficult to pin down, and I mean by that on both sides. It is quite conceivable that three weeks from now we will all of a sudden begin to get some stories of significant wage patterns emerging. The Wall Street Journal will usually show up on the front page with a real [unintelligible] of stories about prices, profits, inflation, and the like, and that could very well be the first indication that something is happening. The point is that no one can write that story at the moment; it is not in the numbers.

Consequently, as far as policy is concerned, where we are at the moment strikes me as quite appropriate to the outlook. I don't feel terribly strongly about it, but I would be inclined to start off merely by assuming that we stay at "B", and that we stay with the $600 million on the borrowing requirement, if for no other reason than it is not a significant edging higher from where we are currently. There is very little doubt in my mind that we can do nothing to the extent of the accumulation of economic activity that is occurring. But I think it does position us in the appropriate place. Having said that, I don't see the need to phrase the directive, as we did the last time, with a tilt toward further tightness. I think for the moment it is probably well enough to stay basically where we are. I don't know where that will fit me in the rest of this group, but I'd love to hear. Mr. Vice Chairman, would you like to voice your opinion?

VICE CHAIRMAN CORRIGAN. I'd be completely satisfied with that formulation--that is, staying with $600 million borrowing and using symmetric language. In a nutshell, I think that is where policy should be.

CHAIRMAN GREENSPAN. That's what?

VICE CHAIRMAN CORRIGAN. In a nutshell, I genuinely think that is precisely where policy should be.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. That's my policy prescription four square.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I am with the Chairman.

CHAIRMAN GREENSPAN. Mr. Boehne.

MR. BOEHNE. I support your proposition.

MR. GUFFEY. Mr. Chairman, I would support the proposition. I would prefer, however, to drop back to the $500 million borrowing level. You said it doesn't take us much from where we are currently, but if, indeed, $100 million equates to about 1/4 percent [on the federal funds rate] you are looking at least at that amount more yet to take place that the market has not perceived. And, since the market doesn't know we have been at $600 million, the $500 million seems more appropriate to me, and that would be my choice.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. I fully agree with these last remarks. I think we are at $500 million and, therefore, we should probably stay around $500 million rather than do further tightening. Let me make one further remark: some data that I have just scratched up indicate that, yes, there have been [similar] episodes before. As a matter of fact, there is a precise duplication of our current situation as far as the exchange rate changes are concerned. And that is that Germany and Japan, between 1980 and 1985, had exactly the same drop in exchange rates. What was their policy? The discount rate was lowered in Japan from 7-1/4 percent in 1980 to 5 percent in 1985; in Germany it dropped from 7-1/2 percent to 4 percent in that period of declining exchange rates. Interest rates on three-month money dropped from 11 to 6-1/2 percent in Japan and from 9 to 5 percent in Germany. As for the one thing that we all worry about--inflation--the CPI in 1980 in Japan was 8 percent and in 1985 it was 2 percent; in Germany it went from 5.4 to 2.2 percent. So, I don't think that the exchange rate really should be driving our policy. And in Germany and Japan, which successfully navigated that period, the exchange rate certainly wasn't taken as a cause to tighten monetary policy.

CHAIRMAN GREENSPAN. In the time frame you were looking at, were they down more than we were in real terms in that time?

MR. HELLER. In real terms what?

CHAIRMAN GREENSPAN. In other words, the differential between U.S. rates and German and Japanese rates in the time frame.

MR. TRUMAN. Their long-term rates essentially rose during that period.

MR. HELLER. They what?

MR. TRUMAN. Their long-term real interest rates rose during that period.

MR. HELLER. Real interest rates you are saying? I haven't looked at real rates; so far they have always been--

CHAIRMAN GREENSPAN. Ours were coming down very significantly at the same time, so it is really a question of [differentials]--although I don't disagree with you, as you know, on the statement you made on the exchange rates at this point.

MR. HELLER. So taking that into account--and for me it is important not to get overly tight on the exchange rate question--I would go with the $500 million, which is current policy, I would argue.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I would favor "B" as you specified it, including the $600 million borrowing target. And I think I would have at least a mild preference for retaining the current asymmetry in the directive for two reasons. One is, as you have pointed out, we really can't find concrete signs of acceleration of inflation in the price or wage data yet. And that, it seems to me, gives us an opportunity to do perhaps a little better on the inflation side than the Greenbook suggests--to lower inflation next year, if we are a bit careful here; and I think that asymmetry in the directive would help on that score. Also, as I think about the near-term outlook--the next six weeks or so--it seems to me the risks are still likely to be in terms of dollar weakness, or some disruptions in the bond market that produce higher long-term rates [associated with] signs of tightening labor markets and growing concerns about acceleration of inflation down the road. The asymmetric directive positions us better should that materialize, and, as I said, that's more likely to be the risk in the very short run.

CHAIRMAN GREENSPAN. Do you think we'll see it in some of the data before then or just in qualitative--?

MR. STERN. I doubt that we would see it in the wage or price data in that time horizon.

CHAIRMAN GREENSPAN. So it is really a question of the evidence that emerges before the numbers begin to show?

MR. STERN. Right. And people's attitudes about what is unfolding.

CHAIRMAN GREENSPAN. Si Keehn.

MR. KEEHN. I agree with alternative B, and I have a preference, at least, for the asymmetrical language as it is currently. Also, if there were going to be a bias, then I suppose the best nuance for the bias about borrowing would be up rather than down from the $600 million level. But I do think changing the fed funds range from 5 to 9 percent perhaps would accomplish that bias.

CHAIRMAN GREENSPAN. So you're going look at "B", $600 million, and you prefer a tilt upward?

MR. KEEHN. Right. I would be for "B", $600 million, and a bias upward.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, my preference is to maintain the current stance of monetary policy and I interpret your formulation as being somewhat of a tightening, albeit fairly slight. The reason I would like to maintain a current stance at the moment is, first of all, as you've indicated, we don't really see any evidence of inflation in the numbers. But, more importantly, as I think I said earlier, over the next several weeks we are going to get some numbers that might produce more volatility in the market. We have this linkage, apparently, between the foreign exchange market and the bond market; if we get a bad trade number again, we probably are going to see a fall in the dollar, and that will be translated into higher bond yields. And that suggests to me that, at that point, we may need to tighten a little; and I would prefer to wait until that time to do anything. So, my difference with you is fairly slight, I think; my formulation would be for borrowing at between $500 and $600 million, with the center of gravity probably in between there, and an asymmetric directive to take account of what I think is going to happen and our need to tighten.

CHAIRMAN GREENSPAN. You're saying "B" with $500 million but a tilt upward?

MR. FORRESTAL. Yes, a tilt upward. It's a "B+" with an asymmetric directive. That's called fine tuning.

CHAIRMAN GREENSPAN. I must say I'm learning a new vocabulary sitting in on these meetings.

MR. BOEHNE. You have only begun, I might say.

CHAIRMAN GREENSPAN. We abrogate the English language every time I come here, it seems. President Parry.

MR. PARRY. Mr. Chairman, at this meeting, I certainly could support alternative B, but I do have a preference for alternative C, for many of the reasons that I mentioned in the go around. The prospect, in my view, is for growth in aggregate demand at, or above, long-run potential. Given the fact that the economy is operating in the zone of full employment, this strength in demand, in combination with the declining value of the dollar can be expected to put upward pressures on prices. Also, growth in labor costs, which is part of our forecast and that of the Board staff's as well, should lead to an underlying inflation rate that is higher in 1988. Moreover, this inflation prospect could be significantly worsened if the expected reduction in Federal government spending does not materialize. Given that it takes a long time for our actions to affect inflation, it is important, in my view, that we not delay until inflation already shows signs of becoming more persistent. Finally, I'd make the point that, if I read footnote 1 on page 10 correctly, it looks to me like, in the not too distant future, alternative C is assumed by the Greenbook, as it is in our forecast. So when we talk about the economy and its performance, and particularly the Greenbook forecast, please keep in mind that that assumes alternative C in the not too distant future. At least that's the way I read that footnote.

CHAIRMAN GREENSPAN. The assumption, of course, is that you agree with that forecast. Governor Seger.

MS. SEGER. I am in favor of no change in the reserve pressure, which I guess is not really a stated option; I am somewhat between "A" and "B", $500 million borrowing target, and I would prefer symmetrical language.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I think that in the short run the risks that we have here in the inflation area are more expectations than anything else, and we should maintain a posture against that, and move against that. I think the economy can handle the slight tightening that going on to $600 million in borrowing would imply. So I favor "B" with $600 million, and would like to see symmetrical language.

CHAIRMAN GREENSPAN. Thank you. President Black.

MR. BLACK. Mr. Chairman, you might think in view of how I stressed the unacceptability of the forecast for next year that I would be advocating "C" as Bob Parry did, but I really think the steps we have taken already have been pretty strong. In fact, we haven't even implemented all we agreed to do last time, so I would not favor anything beyond "B", particularly since I think that there has been a rise in real rates. Also, we have had pretty subdued behavior on the part of the aggregates. But I wouldn't want the symmetrical part of it because I just don't see the likelihood that we would want to ease during this period. As a general rule, I'd rather it be symmetrical because I don't think we usually know; but I think something would be read into it if we eliminated the asymmetry this time.

CHAIRMAN GREENSPAN. Thank you. Governor Johnson.

MR. JOHNSON. I am sort of caught between the $500 and $600 million, but I am basically comfortable with alternative B with symmetric language. I had thought about $500 million with a tilt toward tightening for the same reasons that Bob Forrestal mentioned; there is something in that, too. But I don't feel strongly either way. I would appeal to Peter, though, that in maintaining $600 borrowing--which I think is fine--we ought to do that as smoothly as possible, and not give any obvious signals that might confuse the market into thinking that this is a tightening move. It is going to be perceived that way by some anyway, but I think that we ought to try to do it in as smooth a fashion as possible.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I would align myself with Bob Forrestal's position: "B", with a $500 million borrowings target and asymmetric language. The main thing that is influencing me is a longer-term view and, I guess, trying not to get out of position. And I think Bob Black said it: any way you look at this--whether you look at rates, at the provision of reserves, or at the behavior of the aggregates--over the course of this year, we have taken some significant steps. And I am not quite sure, as I expressed earlier, what the impact of that is going to be. But, being an old market participant, when everybody thinks the same there's a chance that it won't work out that way. Sometimes you get a little afraid of a consensus that is apparently that strong. Having said all that, I could certainly accept "B", with a $600 million borrowing target and symmetric language. But I have a slight preference for the position Bob Forrestal mentioned.

CHAIRMAN GREENSPAN. Vice President Hendricks, would you like to comment?

MR. HENDRICKS. Our preference would be to line up fairly closely with Si Keehn's suggestion on the decision. We would go with $600 million, but would lean on the side of further tightening.

CHAIRMAN GREENSPAN. Vice President Eisenmenger.

MR. EISENMENGER. I support you, Mr. Chairman: $600 million and a symmetric directive.

CHAIRMAN GREENSPAN. Well, it is clear that there is a fairly strong consensus here for alternative B, at $600 million on borrowing; there is a small support amongst the voting members for a tilt toward something stronger in the language, and something on the other side. I, personally, would go along with those vague notions of Governor Johnson on the issue of not fighting the world to try to get $600 million in this maintenance period, because it may be a futile endeavor. It may, in fact, give signals, which is a point that Governor Seger raised earlier in this meeting that struck me as a reason not to specifically fight that number. But, as I read the instructions that I've just been given, the language apparently should read: "In the implementation of policy for the immediate future, the Committee seeks to maintain the degree of pressure on reserve positions sought in recent weeks. Somewhat greater or somewhat lesser reserve restraint would be acceptable depending on indications of inflationary pressures, strength in the business expansion, developments in foreign exchange markets, as well as the behavior of the aggregates. This approach is expected to be consistent with growth in M2 and M3 over the period from August to December at annual rates of around 4-1/2 percent and 6 percent, respectively. M1 is expected to continue to grow relatively slowly. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 5 to 9 percent."

MR. HELLER. Mr. Chairman, did you have symmetric language in there?

MR. JOHNSON. Yes, it's in there.

CHAIRMAN GREENSPAN. Symmetric language.

MR. HELLER. I didn't catch it.

MR. JOHNSON. It's "would" either way.

MR. HELLER. Are they both "somewhat"?

MR. KELLEY. Both "somewhat" and both "would".

CHAIRMAN GREENSPAN. "Somewhat greater or somewhat lesser reserve restraint would be acceptable depending on--"

MR. KOHN. My comment, and it's my fault for putting it in the Bluebook, is that the 4-1/2 percent for M2 sounds excessively precise to me, given my knowledge of how these forecasts are put together. I shouldn't have put it in there, I guess, and I wonder whether--

CHAIRMAN GREENSPAN. You mean you would be precise for us but for the public you don't choose to be precise?

MR. KOHN. Yes, I wonder whether growth rates of from 4 to 6 percent or something like that wouldn't--

CHAIRMAN GREENSPAN. You mean for both aggregates?

VICE CHAIRMAN CORRIGAN. Yes.

MR. KOHN. Yes, wouldn't that capture the spirit? Well, 4 to 6 percent would encourage--

CHAIRMAN GREENSPAN. In other words you'd say "consistent with growth in M2 and M3 over the period from August through December at annual rates of between 4 and 6 percent."

MR. ANGELL. I like "around" 4 and 6--

CHAIRMAN GREENSPAN. Well, no. "Around" means a number--that there's only one number there.

MR. JOHNSON. It says respectively, but you would take--

MR. ANGELL. I know, but, Don, you have a different number for M3 than you do for M2, don't you?

MR. KOHN. Yes, it's 6 percent for M3 and 4-1/2 percent for M2.

MR. ANGELL. See, really, around 4, and around 6.

CHAIRMAN GREENSPAN. Oh, I see. Around 4 and around 6. Is that what you're saying?

MR. JOHNSON. Yes.

MR. KOHN. No. I was actually thinking of 4 to 6, going to a range; but around 4, around 6 would be--

CHAIRMAN GREENSPAN. You mean 4 to 6 percent for both?

MR. KOHN. Yes.

CHAIRMAN GREENSPAN. That's what I thought you said.

MR. ANGELL. But you're actually anticipating 4-1/2 percent and you're anticipating 6 percent.

MR. KOHN. That's correct.

MR. ANGELL. I still think you could miss quite easily with a between 4 and 6.

MR. JOHNSON. You want to say 4 to 6 percent for the M2?

MR. ANGELL. I just asked him--

MR. KOHN. Governor Angell's suggestion would be fine.

CHAIRMAN GREENSPAN. What did he say?

MR. KOHN. Around 4 percent and around 6 percent, respectively.

CHAIRMAN GREENSPAN. So be it. Around 4 percent and around 6 percent, respectively.

MS. SEGER. When the minutes come out do you think a lot would be made of the fact that the fed funds range has been moved? I can just see someone looking at that and saying "Well, clear the decks for the next big tightening of the screws; batten down the hatches."

SPEAKER(?). Well, we really didn't.

CHAIRMAN GREENSPAN. We have set a range that is really merely plus or minus 2 percent from--

MS. SEGER. I know, but people pick at everything that goes down here; and I can just see a big deal being made of this move.

MR. ANGELL. But quite often we really attempt to kind of keep it centered, don't we? We don't like--

MR. JOHNSON. This is what would have been consistent with $600 million borrowings, even before, I think.

CHAIRMAN GREENSPAN. Yes, but the interesting issue would be: if we are now at 7 or 7-1/4 percent and then we came in with the old 5 to 8 percent range, then I think that would really be a big signal.

MR. JOHNSON. 4 to 8.

CHAIRMAN GREENSPAN. But 4 to 8 would essentially be saying that--. You know, I think this reads perfectly. I think this basically says we are already here and we are not going anywhere.

MR. KOHN. In the past when we have done this, we have explained it as a technical adjustment to keep the actual rates more closely centered around there.

MS. SEGER. So there will be an explanation?

MR. KOHN. Yes, there would be some explanatory sentence.

MR. ANGELL. But, I do think it is somewhat important that we follow that suggestion of easing in to the $600 million so as not to cause the markets to believe that we have made a policy change at this meeting.

CHAIRMAN GREENSPAN. Yes, I think the general language on the actions we are taking basically would indicate that we did nothing at this meeting.

MR. ANGELL. Yes.

CHAIRMAN GREENSPAN. As I hear the discussion, that is where we want to be.

MR. BLACK. Could we rephrase that and say we did not change policy rather than we did nothing?

MR. MELZER. Although there will be a perception for a while that we did, I think, as the $600 million shows through--

MR. KELLEY. Sure.

MR. JOHNSON. Well, Peter's skills will take care of that.

SPEAKER(?). Good.

MR. ANGELL. Yes, we have watched him before, and he just knows how to do that.

MR. KEEHN. Not really [unintelligible] instructions; it means he will just do it.

MR. GUFFEY. But he hasn't been too well the last two maintenance periods, have you, Peter?

MR. STERNLIGHT. I haven't been very good.

CHAIRMAN GREENSPAN. Unless there are further comments can we vote?

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
Governor Heller	Yes
Governor Johnson	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor Seger	Yes
President Stern	Yes

END OF MEETING